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Montana Science & Technology Alliance Report

Striving to promote a partnership between government, academia & business

Legislation Enacted to Impact Montana's Business Climate and Future of the Alliance

During the recent legislative session, several bills were enacted that will beneficially affect the future of the Montana Science and Technology Alliance and Montana's business climate.

First, House Bill 700, the Alliance's seed capital bonding bill, received the required three-quarters vote of both houses of the legislature. This bill authorizes the Alliance to issue up to $16 million in taxable bonds over the next six years with the proceeds being used for direct investments in seed stage companies that are actively moving toward commercialization and for investment in up to three in-state venture capital companies that, in turn, would invest directly in individual projects.

The bonds will carry a deferred debt service feature allowing adequate time for earnings on the investments to be realized and consequently to

MSTA to Move

The Montana Science and Technology Alliance is moving to a new location. The tentative effective date of the move is August 1, 1987. Our new address will be:

Montana Science and Technology Alliance
46 North Last Chance Gulch, Suite 2B
Helena, Montana 59620

In order for the Alliance to continue serving you, please make note of this change in your records.

Governor Ted Schwinden signing H.B. 700, the Alliance's seed capital bonding bill, into law. Also present, left to right, are Representative Jack Ramirez, Sam Hubbard, Senator Bob Williams, Senator Gene Thayer, Steve Browning, Representative John Vincent, Representative Dorothy Bradley, Representative Bob Marks and Senator Neuman.

PLEASE RETURN

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State of Montana

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cover the debt service on the bonds. To make the bonds investment grade, the Coal Tax Trust Fund will be used as security, meaning that if the investment earnings are not adequate to pay the debt service when due, the trust will be called upon to subsidize those payments.

The program will provide a significant pool of seed or risk capital in Montana and help stimulate the formation of private sector venture capital.

Venture capital investors usually expect about three or four projects out of every ten to fail, another three to four to break even, and the final two or three to perform extremely well, usually well enough to offset the losses from the failures. An average yield of about 13 percent on Alliance investments would produce adequate funds to retire the bonds without help from the trust. If additional earnings are realized, they will be deposited in the trust fund.

Of the $16 million to be raised over the next three biennia through bond sales, $12 million will be directly managed by the Alliance, $3 million will be placed with private Montana capital companies (with at least a dollar-for-dollar match from private sources required), and $1 million will be used for costs of issuance and administrative expenses.

This program will accomplish two critical economic development objectives. First, it will provide a significant pool of seed or risk capital for investment in early stage entrepreneurial companies in Montana. Second, it will significantly help to stimulate the formation of private sector venture capital.

The second important piece of legislation enacted was Senate Bill 22, which amended the Montana Capital Companies Act. The amended act now entitles an individual, small business corporation, partnership or corporate taxpayer who makes an investment in a Montana capital company to receive a tax credit equal to 50 percent of the investment, an increase from the earlier limit of 25 percent. This tax credit will be available for the next four years and will affect the Montana economy in two ways. First, it will stimulate the formation of additional Montana capital companies. Currently only one such company operates in Montana. Second, the investments in these capital companies will create a larger available investment pool that will in turn be available for investment in early stage companies throughout Montana.

The third piece of legislation of strong interest to the Alliance is House Bill 449, which encourages the Montana Board of Investments to invest up to 3 percent of the state retirement funds with venture capital companies. It further urges the Board of Investments to give preference to those venture funds that demonstrate an interest in investing in Montana projects.

House Bill 449 encourages the Montana Board of Investments to invest up to 3 percent of the state retirement funds with venture capital companies.

The investment of pension funds in venture capital companies is an investment option that is increasingly popular with pension fund managers in both the public and private sectors. Approximately one-third of the $24 billion under management by venture funds in this country is provided by public and private pension funds. At least 21 other states are active venture investors, including Washington, Oregon, Nevada, Utah, Colorado, Iowa and Wisconsin among others. In addition, investment of Montana dollars in these venture capital companies would create a powerful incentive for the companies to seriously consider Montana projects for investment. This could help fill a huge gap in available investment capital for early stage entrepreneurial companies in Montana.

Finally, the legislature substantially increased the Alliance's spending authority for research and development and technology transfer activities. During the next biennium, $2.75 million will be available for such efforts as the creation of advanced technology centers of excellence, the development of business development assistance services, applied research projects, and technology transfer efforts. Appropriated from the Alternative Energy account, this source of funds will enable the Alliance to continue to pursue aggressively advanced technology research and development activities in Montana.

Governor Appoints Three New Members to the MSTA Board of Directors

Dr. Koch

Ms. Bear

Mr. Ribi

Governor Schwinden appointed three new members to the Alliance board of directors to fill vacancies created by earlier resignations. The three new members are James Koch, Barbara Bear and Nils Ribi.

James V. Koch is the president of the University of Montana and is the fourth public member of the board. He was appointed to the board last fall to replace Dr. Neil Bucklew. Before assuming the presidency of U of M, Dr. Koch served as provost and vice president for academic affairs at Ball State University in Indiana and previous to that held academic positions at a number of other universities. He has a doctorate from Northwestern University and a honorary doctorate from Yeungnam University in Korea. He brings to the board his expertise in economics and knowledge of the considerable assets and programs available at the university.

Barbara J. S. Bear is the assistant vice president and manager of retail lending for First Bank in Livingston. Previous to this position, she served as a private consultant to local banks in the areas of credit administration and credit analysis for commercial real estate applications and basic commercial lending procedures. Before moving to Montana in 1984, she served as an assistant vice president for a bank in Philadelphia. She has a bachelor of arts degree in economics from Randolph-Macon Woman's College as well as additional finance education at Temple University and the University of Virginia-Colgate Darden Business School. She brings to the board her diverse experience in business credit analysis and small business administration.

Nils A. Ribi is the chairman of the board for Ribi ImmunoChem Research, Inc., in Hamilton. Mr. Ribi has held a series of increasingly responsible positions at Ribi ImmunoChem since joining the company in 1981. Ribi ImmunoChem is a leader in the development of general immune stimulants or "adjuvants," primarily for human use. Previous to joining Ribi, he held positions in financial administration for several large companies. He has a bachelor of science degree in business administration from the University of Montana and has masters level course work in business administration at Eastern Washington University. He brings to the board his experience in directing biotechnology research, in operating a small, high technology-based company and his knowledge of the U.S. Food and Drug Administration approval process.

First Return on Investment Payment Received from GeoResearch, Inc.

The Alliance received its first return on investment payment in March of this year from GeoResearch, Inc. GRI, a Billings firm and recipient of an Alliance technology investment in April of 1986, presented a check for $93.63 to the Alliance. Under the terms of the investment agreement, GRI is obligated to pay five percent of the revenues generated from sales of its remote electronic animal data system (READS) to the Alliance. This is the first return on investment payment the Alliance has received and, coming after a little more than a year of placing technology investments, it was earlier than anticipated.

MSTA Board Invests in Nine Technology Projects

The Montana Science and Technology Alliance board of directors voted to invest in nine projects at its meetings in January and May, 1987. Total funds committed to these projects are $624,520, bringing the total funds under contract by the end of June, 1987 to $1,522,918. If all of these projects are successful, over 2,700 new jobs could be created in Montana by 1992.

At the board's January meeting, three projects were awarded technology investments totalling $278,740. A $150,000 investment commitment was made to Athtec Systems, Inc., to complete the prototype development and integrate the software into the Athtec Robotic Manipulator ("ARM"). The ARM is a computer-controlled and designed device for diagnostics and rehabilitative therapy on the musculoskeletal system. Under the board's terms Athtec, the winner of two National Small Business Innovation Research grants totalling $550,000, would relocate from California to Montana.

Under the board's terms, Cytek would relocate from California to Missoula.

The board also voted to invest $100,000 in Cytek Biostimulation Technologies to complete the product development of a new low powered laser device to be used as a new dental treatment method for periodontal disease. Upon receipt of USFDA premarket approval, the company will begin testing the device on a limited clinical trial basis. Prior to receiving board funds, the company plans to relocate from California to Missoula.

The final board action in January was to invest $28,740 in a Montana State University project proposed by Dr. C.W. Newman to study the effect of extrusion processing on the nutritional quality and feed value of barley for calves, lambs and pigs. The goal is to enhance the feeding value of barley to Montana livestock and possibly increase barley's competitiveness with other grains sold to the Pacific Rim countries.

At its meeting in May of 1987, the board voted to invest $345,780 in an additional six projects. The investment commitments will include those committed to during this biennium as well as those to fall into the next biennium.

At its meeting of May, 1987, the board voted to invest in an additional six projects.

The board voted to invest $125,000 in Life Resonances, Inc., of Bozeman, to complete the final applied research and prototype development of the company's cyclonic resonance device and complete a corporate strategic plan including development of a comprehensive business plan. The research work will be conducted at Montana State University facilities. The instrument, if successful, will be used initially in human therapeutic medical applications with future applications in human preventative medicine and veterinary medicine as well as industrial applications.

The board also voted to invest $20,000 in Mycotech, Inc., of Butte. Mycotech will use the investment to conduct an evaluation of its enzyme technology, the marketing potential of its enzyme products and to assess the potential of utilizing the company's first product, cellulase, as a cattle feed supplement.

The board also voted to place a second investment in Ercon Systems, Inc., of Great Falls. Last year the board invested $20,000 in the company to allow it to develop two prototype machines necessary to produce an erosion control matting product made from used tires and initiate site-testing of the product. This second investment will be used by Ercon to obtain an engineering evaluation of these machines, a geohydrologic analysis of the test site protocol and testing and to develop a strategic corporate plan including a five year business plan.

The board voted to reserve $100,000 as a second investment in ChromatoChem, Inc., of Missoula. ChromatoChem was the recipient of the board's first technology investment in early 1986 to manufacture and sell high performance affinity chromatography products for the separation, purification and analysis of high value-added chemicals and biochemicals. ChromatoChem has now developed an initial sales contract with Genentech and will use the Alliance funds to help bring its initial products to market.

The board voted to invest $50,600 in a technology transfer project directed by the Montana Wool Growers Association and conducted in cooperation with Montana State University's extension service. The objective of the project is to transfer the latest in sheep management technology to target sheep ranchers throughout the state in order to increase sheep production efficiency and ultimately the profitability and competitiveness of Montana's sheep ranchers.

The board further voted to invest $50,000 through the Montana Ambassadors to assist the Governor's office in preparing the state's application to attract U.S. West's major research facility for its advanced technoloty subsidiary to Montana. The proposed facility will employ as many as 1,500 people engaged in research and development relating to the telecommunications industry. U.S. West is undertaking a search for a location for this subsidiary in its 14-state service area.

The objective of the Wool Growers' project is to transfer the latest in sheep management technology to increase sheep production efficiency and competitiveness of Montana's sheep ranchers.

Finally, the board voted to invest $30,180 in a technology transfer project proposed by Thomas Welch of Northern Montana College. The board's investment will be used in two ways. First, it will provide technology transfer training during a summer seminar in computer management skills for county agents and vocational agriculture teachers who will in turn transfer these technology skills to farmers and ranchers throughout the state. Second, it will be used to operate an electronic bulletin board system accessible to farmers and ranchers, vocational agriculture teachers and county agents to provide updated information and answer questions.

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Venture Investing

People unfamiliar with the Montana Science and Technology Alliance sometimes ask about the "loans" given to Montana companies. In fact, the Alliance's investments are quite different from conventional loans such as a bank would handle, since one of the Alliance's primary functions is to provide funding to innovative technology companies that banks would consider too risky. Thus, the Alliance operates much more like venture capital investors. Such investors typically invest in a company by buying an equity share, which is then sold for a profit once the company has reached a certain stage of growth.

This approach to funding is much riskier than a loan, since the return on investment is tied to the success of the company; if the company grows and prospers, the venture investor sells his share for much more than the original investment, aiming for a return of ten times his initial investment in five to seven years. But if the company fails, then the venture investor shares that loss.

One of the Alliance's primary functions is to provide funding to innovative technology companies that banks would consider too risky.

With careful investments, a venture investor can earn enough on the successful investments to more than make up for the occasional failure. One essential factor venture investors consider is the potential for a company to achieve dramatic growth in a short period of time, a factor usually tied to an innovative technology or product which enables the company to capture the first big share of a new market. More conventional financial institutions, like banks, are risk averse and tend to enter the picture after venture investors have exited, waiting for small or new companies to become established, with a record of profitable operations, before they are willing to lend these companies money.

The Montana Science and Technology Alliance operates somewhat differently than private sector venture capital firms. Although the Alliance is prohibited by statute from owning an equity position in any company, it is currently exploring the possibility of purchasing a convertible debenture, which is closer to equity than the earlier payback approach. This would enable the Alliance to more easily syndicate its investments with private sector venture capital investors during the current or subsequent needed rounds of investments.

One essential factor venture investors consider is the potential for a company to achieve dramatic growth in a short period of time.

At the point of investment in the company, the Alliance would be issued a convertible debenture by the company. Its value would be commensurate with the amount of the Alliance's investment in the company and pegged to the valuation of the company at the time of issuance. During the time the Alliance owned the debenture, the debenture would yield a specified annual percentage return to the Alliance. At its exit point from the investment in the company, the Alliance would then sell the debenture to another party. While the Alliance would be unable to convert the debenture to stock, or an equity position, in the company, the purchaser of the Alliance's debenture would be able to do so. If the company matures and realizes a high growth rate with requisite earnings as described in its business plan during the term of the Alliance's investment, the valuation of the company and consequently the value of the debenture will rise accordingly.

When one remembers that such companies as DEC, Intel, Genetech and Apple Computers were all initially backed by venture capital, it is clear that the rewards of such investments can be great.

In order to minimize the risk inherent in investing in companies with no "track record," the Alliance subjects all prospective companies to careful review, or due diligence process, before making a decision to invest. But it is inevitable that some of the companies invested in will not be successful because by its nature, this type of investment is risky. When one remembers that such companies as DEC, Intel, Genentech, and Apple Computer were all initially backed by venture capital, it is clear that the rewards of such investment can be great.

In addition to any dollar return on investment to the Alliance, a successful project can benefit the state in a number of ways, with the creation of jobs, better utilization of resources, stimulation of university research, more cooperation between the universities and private businesses, and the enhancement of Montana's image as a state where innovative, technology-based businesses can thrive. The important point to consider is that the kinds of projects backed by capital investors are unlikely to find other sources of capital. Thus, the Alliance's support can be essential to the entrepreneur who is trying to move from the idea or prototype stage to a point where profits start to come in. Without this type of investment in seed or start-up stage companies, many potentially profitable enterprises would never come to fruition.

Project Applications Deadlines

Effective this July, there will no longer be any formal project application deadlines. Please be aware, however, that a funding decision can take as long as six months.

If You Want More Information

Contact MSTA at:
406/444-3707
46 North Last Chance Gulch, Suite 2B
Helena, Montana 59620

MSTA Sponsors Second Annual Venture Capital Forum

The second annual Montana Venture Capital Forum will be held on Thursday and Friday, July 30th and 31st in Bozeman, Montana. The first forum, held in November of 1986 at Grouse Mountain Lodge in Whitefish, was attended by 70 participants.

The goal of the second forum will be to introduce venture capital investors to the state, its technology development capabilities and most importantly, selected young high growth seed and start-up stage companies that are developing in Montana and seeking investment capital. Representatives from thirty-five venture capital firms from the Denver-Boulder, Seattle, Portland and Minneapolis areas are invited. Other out-of-state guests will include representatives from other firms involved with venture investment, while in-state participants will include representatives from the three major Montana universities, various Montana technology-based companies, the Montana Board of Investments and the Alliance board of directors.

The conference will start off with a morning session devoted to a discussion of doing business in Montana. The later morning and afternoon session will consist of a series of presentations by up to 15 technology-based, high growth

companies seeking capital. Friday's agenda will consist of small breakout sessions that will provide the investors with an opportunity to spend more time with the companies in smaller group settings.

Several benefits are expected from the forum. First, venture investors will be exposed to a number of potential investment opportunities and will hopefully choose to place investments with some of the companies. As a result of the first forum last fall, negotiations between a number of the presenter companies and venture investors begun at the forum resulted in over $2.6 million of venture capital being offered to those companies. Second, the venture investors will be exposed to the state's entrepreneurial activity as well as the potential for continued investment opportunities in the future. Finally, the presenter companies and other in-state participants should gain valuable insights into the workings of the venture capital community and how to apply this knowledge for the benefit of all of Montana's economy.

Persons interested in attending the forum should contact the Montana Science and Technology Alliance as soon as possible at 406/444-3707 since there is limited space available. The registration fee is $100 and all meals will be provided.

MSTA Meeting Dates

Effective this July, the Board will begin meeting on a monthly basis with the meetings set for the last Thursday of the month.

The next meeting of the Board will be Wednesday, July 29th in Bozeman in conjunction with the Montana Venture Capital Forum.

The August Board meeting is tentatively scheduled for Thursday, August 27th in Helena.

Department of Commerce
46 North Last Chance Gulch, Suite 2B
Helena, Montana 59620

Montana Science & Technology Alliance

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